BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

LeRoy Koppendrayer	Chair
Marshall Johnson	Commissioner
Ken Nickolai	Commissioner
Phyllis A. Reha	Commissioner
Gregory Scott	Commissioner

In the Matter of a Filing by Aquila, Inc. to Establish a Large Volume Daily Balancing Service

ISSUE DATE: February 27, 2004

DOCKET NO. G-007,011/M-03-276

ORDER APPROVING AQUILA'S LARGE VOLUME BALANCING SERVICE WITH MODIFICATIONS

PROCEDURAL HISTORY

On March 21, 2003, the Commission issued its ORDER APPROVING WITHDRAWAL OF COMPLAINT AND OPENING TWO NEW DOCKETS,[1] which required, among other things, that Aquila, Inc. (Aquila) offer a regulated Large Volume Daily Balancing Service and participate with the Department of Commerce (DOC), Pro-Corn, and OTESCO[2] in jointly developing and submitting a regulated Large Volume Daily Balancing Service for Commission review within 60 days from the date of the Order. The Large Volume Daily Balancing Service matter was assigned to the current docket.

On June 30, 2003, Aquila filed its petition to establish a Large Volume Balancing Service (LVBS).

On July 30, 2003, the DOC held a technical conference to discuss Aquila's proposed LVBS.

On August 15, 2003, Aquila submitted a supplemental filing, revising its original filing of June 30, 2003.

On September 12, 2003, OTESCO submitted comments.

---

[1] *In the Matter of the Complaint of Pro-Corn, LLC Against Aquila, Inc. (Formerly UtiliCorp United Inc.),* Docket No. G-007,011/C-02-1602, ORDER DENYING RECONSIDERATION (May 30, 2003).

[2] Otter Tail Energy Services Company.

On September 15, 2003, the DOC and Cornerstone Energy, Inc. (Cornerstone) each submitted comments. The Large Power Intervenors [3] also submitted comments on September 15, 2003.

Reply comments were submitted by Aquila on September 29, 2003, and by the DOC and Cornerstone, each, on September 30, 2003.

This matter came before the Commission on January 22, 2003.

FINDINGS AND CONCLUSIONS

I. Aquila's Proposal

1. Background

Aquila makes transportation service available to non-general service customers that purchase gas from a party other than Aquila. The third party delivers the gas needed by the customer to an Aquila town border station (TBS) and Aquila then delivers this third party gas from the TBS to the customer on a firm or an interruptible basis. The transportation customers who take this service are required to be in balance on a daily basis. If nominations do not equal deliveries on a daily basis according to the terms of Aquila's transportation tariff, the transportation customer is subject to the daily imbalance scheduling penalties in Aquila's transportation tariff. In addition, any cumulative over or under deliveries must be paid for (cashed out) by the customer at the end of the month.

Under normal operating conditions, when a transportation customer uses gas volumes that vary from the volumes nominated by more than 5% during a twenty-four hour scheduling period (or gas day), a pipeline penalty is incurred. A transportation customer may purchase the LVBS in order to avoid, to some extent, those penalties. The LVBS increases the amount of variance that a customer can have between the amount it nominates and the amount actually used without incurring a penalty.

2. Aquila's Proposed Large Volume Balancing Service

a. Limitations

Aquila proposed making its LVBS available to any non-general service transportation customer that has installed telemetry equipment and to marketers that have pooled the volumes of their Large Volume Transportation customers with telemetry equipment installed.

---

[3] Hibbing Taconite Joint Venture, Ispat Inland Mining Company, Keewatin Taconite Company, Northshore Mining Company and United States Steel Corporation (collectively, the Large Power Intervenors).

Customers can purchase LVBS units supporting up to twenty percent of their peak day usage.

The service would not be available on days when the pipeline issues System Overrun Limitation (SOL), System Underrun Limitation (SUL), or Critical Days. Further, the service would not be available on days when Aquila issues a Curtailment order or any other day that Aquila believes that the service could be detrimental to its General Service customers.

b. Rate Development

Aquila's goal in developing the rate for the LVBS was to ensure that the sales customers did not subsidize the transportation customers that choose to purchase this service. Since the cost of providing this service would be borne by the sales customers through the Purchased Gas Adjustment (PGA), the revenue from this service would accrue to the PGA as a credit against the cost of gas supplies charged to sales customers.

Aquila's LVBS rate is made-up of three rate elements: 1) System Management Service (SMS) costs (including demand and commodity components); 2) Firm Capacity costs; and 3) a Commodity Risk cost. Aquila proposed a total rate for this service of $5.47 per Mcf per month, based on the following three components:

1. SMS:[4]
   a. demand: $1.75
   b. commodity: $0.22

2. Firm capacity: $1.76

3. Commodity risk: $1.74 [5]

Each component will be discussed in turn.

The SMS demand and commodity component was designed to recover the cost of SMS purchased from Northern Natural Gas Company(Northern) that is used to support this service. Aquila proposed that this element of the LVBS would be adjusted whenever the Federal Energy Regulatory Commission (FERC) authorizes a change in Northern's SMS rates.

The firm capacity component of this rate was based on Northern's requirement that in order to purchase SMS, the Northern transportation customer must also have rights to Northern's firm

---

[4] The SMS demand and commodity rate component is based on Northern's SMS rates as of June 30, 2003.

[5] This rate reflects the commodity risk component as revised in Aquila's August 15, 2003 supplementary filing.

transportation service. Aquila's firm transportation rights on Northern are purchased for firm sales customers; they are required by sales customers and are paid for by sales customers. None of this cost is paid for by Aquila's transportation customers. For this reason, Aquila proposed including a firm capacity charge in its LVBS rate. This charge represents the market value of this capacity to Aquila's transportation customers. This component would protect sales customers from subsidizing the cost of providing LVBS to these customers. If the value of the capacity releases were to change materially, Aquila stated that it would make a miscellaneous tariff filing to adjust the firm capacity component of this rate.

The commodity risk component was designed to capture and quantify the potential for subscribers to LVBS to game the service by under-nominating during periods when prices were high and/or over-nominating during periods when prices were low. Generally, large volume transportation customers are required to stay in balance, within a plus or minus five percent tolerance, on a daily basis. However, if a transportation customer was outside of that tolerance, it could potentially increase costs to the Company's sales customers by requiring the Company to either purchase additional gas at higher prices (to make up for inadequate gas supples that result from under nomination) or sell incremental gas at lower prices (to eliminate excess gas supplies that result from over nominations). These losses would be ultimately passed through to sales customers through the PGA. This component was designed to address this issue.

Aquila's tariff for transportation service includes a monthly cash-out procedure similar to Northern's monthly cash-out procedure. If Northern were to modify its cash-out procedure, Aquila would likely make a change to its procedure. Aquila indicated that if that were to take place, it is possible that the commodity risk component could decrease.[6]

3. Changes to Aquila's Proposal Resulting from the Technical Conference

Aquila, in its supplemental filing, responded to the comments of the parties attending the technical conference[7] by making the following revisions to its original proposal:

---

[6] On December 23, 2003, in Docket No. G,007,011/M-03-2008, Aquila submitted a miscellaneous tariff filing to propose changes to its balancing and scheduling charges for its transportation customers. In its filing, Aquila proposed to align its balancing and scheduling charges with the balancing and scheduling changes authorized for Northern in FERC Docket No. RP03-398. Aquila's filing is pending.

[7] Held July 30, 2003 with representatives from Aquila, Cornerstone Energy, NNG, Otter Tail Energy Services Company, CenterPoint Energy Services, U.S.Energy Services, Inc. Mackall, Crounse and Moore PLC, Virginia Power Energy Marketing, Inc.(by phone), the DOC and the Public Utilities Commission attending.

- offering the service as a pilot program beginning at the end of the 2003-2004 heating season and ending August 31, 2005, with any proposed changes to the program being filed by Aquila by May 31, 2005;

- limiting the amount of LVBS that will be offered during the pilot program to 2,000 units.[8]

Aquila accepted the recommendations made by the DOC (see below) to its proposal.

II. Parties' Positions

A. DOC

The DOC recommended that the Commission approve the proposed rate of $5.47 per Mcf per month of LVBS.

1. Rate Components

The DOC determined that Aquila's proposed calculation of the SMS component of the LVBS rate was reasonable and consistent with Federal Energy Regulatory Commission's (FERC) approved construction. However, the DOC did not support Aquila's proposal that would allow an automatic update of the LVBS if Northern's SMS rate changes. Rather, the DOC recommended that Aquila be required to get Commission approval prior to changing the SMS component. The DOC proposed specific tariff language to modify proposed Section 12:1 of Aquila's Transportation Rate Schedule that would reflect the DOC's position on this matter. [9]

The DOC concluded that the firm capacity component of Aquila's proposed rate was reasonable to compensate the Company's sales customers for the loss of capacity release revenues that would likely result from the LVBS. The DOC recommended that Aquila obtain Commission approval before making a change to the firm capacity component.

---

[8] This limit would not likely result in Aquila having to purchase any additional SMS during the pilot period. This limit should eliminate any stranded SMS cost issues during the pilot period and postpone the necessity of making a decision on the final size of the program, the appropriateness of exit fees, and any requirements on the term of LVBS service contracts.

[9] The DOC's recommended tariff language is set forth in Section II.B.vii of the DOC's September 15, 2003, comments. The language recommended by the DOC states: " …The Company will submit a miscellaneous tariff filing, including revised tariff sheets, with the Minnesota Public Utilities Commission any time it proposes to adjust this rate due to a change in the SMS rate.…"

The DOC also concluded that the commodity risk component was a reasonable attempt to mitigate the risk that LVBS customers may be more out-of-balance (and cause increased costs to sales customers) than before subscribing to the service. The DOC recommended that Aquila obtain Commission approval prior to changing the commodity risk component.

Further, the DOC agreed with Aquila that it would not be reasonable to impose a cash-out mechanism that is different or more frequent than Northern's cash-out mechanism.

In response to the Large Power Intervenors question of whether Aquila's proposal to pass any costs or revenues related to the LVBS through the PGA was in compliance with Minnesota Statutes, the DOC, after analyzing each rate component separately, determined that doing so was consistent with past Commission Orders and consistent with Minnesota law.

2. Conditions of Service

The DOC supported the limitations on participation in the LVBS proposed by Aquila. These include:

- The LVBS would be available on a pilot basis ending August 31, 2005, with any proposed changes to the service being filed by the Company no later than May 31, 2005;
- The program would be available only to Transportation customers that have telemetry installed or to marketers that have pooled volumes of telemetered Transportation customers;
- An LVBS customer could purchase up to a maximum of twenty percent of that customer's peak day usage;
- The LVBS would not be available on days when the pipeline issues SOL, SUL, or Critical Day notices because Northern's SMS is not available on those days;
- The LVBS would not be available on days when Aquila issues a Curtailment order or any other day that Aquila believes that the service could be detrimental to its General Service customers;
- The amount of LVBS that will be offered during the pilot period would be limited to 2,000 units;

The DOC agreed that implementing the program on a pilot basis, as described by Aquila, was reasonable. The DOC recommended that Aquila include in its May 31, 2005 filing the following information:

- the number of customers participating in the pilot project;
- the amount of LVBS subscribed to by each customer;
- the costs associated with implementing the pilot project;
- the revenues associated with the pilot project.

3. Other DOC Recommendations

The DOC also made the following recommendations:

- that Aquila be required to address the issue of potentially stranded SMS costs, together with possible alternative solutions, in its May 31, 2005 filing;

- that only Large Volume Transportation customers and marketers that serve Large Volume Transportation customers be allowed to participate in the LVBS during the pilot period; (The DOC argued that Aquila's Super Large Volume Transportation customers have received several competitive bids to provide a balancing service and do not need access to the LVBS during the pilot period. Aquila's small volume transportation customers may subscribe to Aquila's small volume balancing service.)

- that Aquila adopt the Department's proposed tariff language for the fifth paragraph of proposed Section 12:1 of Aquila's Transportation Rate Schedule, as described in section II. B. vii of the Department's comments (see footnote 9 of this Order); and

- that Aquila file, within 20 days of the Commission's Order in this docket, relevant tariff sheets that reflect the Commission's determination in this docket.

B. Cornerstone Energy

Cornerstone requested that the Commission reject Aquila's LVBS offering. It argued that the market currently provides these services and no customers have come forward in support of Aquila providing these services. Cornerstone argued that Aquila's proposal fails to protect the interests of the Company's General Service customers because the commodity risk component of the rate was set too low and exposes Aquila's General Service to too much risk. Further, Cornerstone argued that Aquila did not include administrative costs in its estimate of the proposed rate.

C. OTESCO

OTESCO supported the Commission's efforts to require Aquila to establish a LVBS but OTESCO believes that the tariff as designed by Aquila is not in the public interest nor is it in the interest of Minnesota customers. OTESCO argued that Aquila's proposed balancing service is nearly 150% higher than Minnegasco's and Xcel's balancing service due to the addition of the commodity risk component. OTESCO argued that the potential risks to Aquila associated with price volatility are overstated and not quantifiable.

OTESCO opposed the program being offered on a pilot basis but argued that if it was to be offered on a pilot basis it should be for a minimum pilot period of five years to ensure all transportation customers the opportunity to participate in the program, if they so desired. It argued that many potential customers continue to be under balancing agreements with Cornerstone that would prevent migration to the new LVBS offered by Aquila within the one year pilot program. Further, OTESCO argued that the term of service be on a month to month basis, or if on a one year basis, customers should be allowed to change the amount of balancing service they subscribe to on a seasonal basis.

OTESCO also opposed the proposal to limit the size of the pilot program to 2,000 units. OTESCO argued that Cornerstone could buy all of the available units and prevent other marketers from using this service. Alternatively, OTESCO recommended that Cornerstone's participation be limited to 1,000 units (or one-half of the available units) so that other marketers have a chance to participate in this program.

D. Large Power Intervenors

The Large Power Intervenors argued that Aquila should not be required to offer a large volume balancing service as there are a plethora of non-regulated balancing alternatives available. As evidence of this, they stated that every member of the Large Power Intervenor group has been repeatedly offered balancing services by more than a dozen gas marketers active in the Minnesota market. Further, the Large Power Intervenors stated that if Aquila is required to provide this service, they would recommend that Aquila set the rate high enough to minimize any potential loss from providing this service.

The Large Power Intervenors objected to Aquila's proposal because the balancing service customers, since they are transportation customers and not subject to the PGA, are not at risk for paying the cost of Aquila's under and over recoveries while Aquila's sales customers, who are subject to the PGA, would incur all of the risk but would not use this service. The Large Power Intervenors argued that this apportionment of risk between Aquila and its General Service customers should be decided in a rate case. Further, the Large Power Intervenors argued that it may be contrary to Minnesota Statute to allow Aquila to recover the cost of this service and any under and over recoveries through Aquila's PGA, as proposed by Aquila.

III. Commission Action

The Commission is in agreement with the DOC that Aquila's proposal, with the modifications proposed by the DOC and accepted by Aquila, is reasonable and in the public interest. The Commission will approve the proposal with the DOC's modifications.

The rate Aquila has proposed includes an attempt to mitigate the risk that LVBS customers would cause increased costs to Aquila's General Service (sales) customers. It does so by quantifying these risks in the firm capacity and commodity risk components of the LVBS rate and apportioning these costs to the LVBS customers who will be using this service. The revenue from this service will then be returned to General Service customers through Aquila's Purchased Gas Adjustment mechanism. The Commission finds this approach reasonable and agrees with the DOC that Aquila's proposed calculation of these rate components is also reasonable and adequately compensates General Service customers for the use of these resources and the potential risk incurred.

In order for the Commission to continue to evaluate these rate components, the Commission will require the Company to obtain Commission approval before the Company makes any changes to any of the rate components.

The Commission also agrees with the DOC that Aquila's proposal to pass the costs and revenues associated with the LVBS through the PGA is consistent with previous Commission decisions and in compliance with Minnesota law.

Further, the Commission agrees with the DOC that the limitations on this service proposed by the Company are reasonable and the Commission will approve them. Limiting the balancing service to customers with telemetry to ensure that Aquila will have the necessary information to determine the degree to which a customer is in balance, limiting the maximum amount of LVBS available to any one customer, which will act to mitigate gaming while still providing adequate additional tolerance for most customers, and suspending the LVBS upon certain occurrences in order to ensure system reliability, are reasonable limitations that will enable Aquila to provide an efficient service.

The Commission finds that It is reasonable to limit the amount of LVBS that Aquila can sell during the pilot period to 2,000 units of LVBS, an amount that can be provided without Aquila purchasing any incremental SMS. This will eliminate any potential stranded costs issue during the pilot period. However, when the Company submits its filing in May 2005, Aquila will be required to address the stranded costs issue and possible solutions .

Because the number of units of the LVBS to be offered is limited, and in order to ensure that no one party could purchase all of the units available, the Commission will limit the amount that any one party can purchase to no more than half of the available units. This will ensure that this pilot program will be available to any party that is interested.

Finally, the Commission agrees with the DOC and the Company that a one year pilot program will provide sufficient time to review the utilization of the service, evaluate the program, and enable Aquila to request any adjustments.

ORDER

1. The Commission approves Aquila's proposed LVBS with the following modifications:

   a. The LVBS is approved on a pilot basis ending August 31, 2005, with any proposed changes to the service being filed by the Company no later than May 31, 2005,

   b. The proposed rate of $5.47 per unit of LVBS is approved,

   c. Participation shall be restricted to any non-General Service Transportation customers that have telemetry installed or to any marketer that has pooled the volumes of any Large Volume Transportation customer that has telemetry installed,

   d. Only Large Volume Transportation customers shall participate in the LVBS during the pilot period,

   e. Aquila shall restrict the amount of LVBS that a customer can purchase to a maximum of twenty percent of that customer's peak day usage,

   f. Aquila shall be allowed to suspend the LVBS on days when the pipeline issues SOL, SUL, or Critical days, consistent with Northern's SMS provisions,

   g. Aquila shall be allowed to suspend the LVBS on days when Aquila issues a Curtailment or any other day that Aquila believes that the service could be detrimental to its general service customers,

   h. The amount of LVBS to be offered during the pilot period shall be limited to 2,000 units,

   i. Aquila shall obtain Commission approval prior to changing the SMS component,

   j. Aquila shall obtain Commission approval prior to changing the firm capacity component,

   k. Aquila shall obtain Commission approval prior to changing the commodity risk component;

   l. Aquila shall include the following information in its May 31, 2005 filing:

      i) the number of customers that are participating in the pilot project,
      ii) the amount of LVBS subscribed to by each customer,
      iii) the costs associated with implementing the pilot project, and
      iv) the revenues associated with the pilot project;

m. Aquila shall address the stranded costs issue, together with possible alternative solutions, in its May 31, 2005 filing;

n. Aquila shall adopt the DOC's proposed tariff language in the fifth paragraph of proposed Section 12:1 of Aquila's Transportation Rate Schedule, as described in section II. B. vii of the DOC's comments of September 15, 2003 (and in footnote 9 of this Order);

o. No party shall be allowed to purchase more than one-half of the available LVBS units.

2. Aquila shall file, within 20 days of the Commission's Order in this docket, relevant tariff sheets that reflect the Commission's determination in this docket.

3. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Burl W. Haar
Executive Secretary

(S E A L)

This document can be made available in alternative formats (i.e., large print or audio tape) by calling (651) 297-4596 (voice), (651) 297-1200 (TTY), or 1-800-627-3529 (TTY relay service).